

VZCZCXRO1491  
OO RUEHDBU RUEHFL RUEHKW RUEHLA RUEHNP RUEHROV RUEHSR  
DE RUEHSI #0750/01 1061320  
ZNY CCCCC ZZH  
O 161320Z APR 09  
FM AMEMBASSY TBILISI  
TO RUEHC/SECSTATE WASHDC IMMEDIATE 1404  
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 TBILISI 000750

SIPDIS

E.O. 12958: DECL: 04/14/2019  
TAGS: [ECON](#) [ENRG](#) [PGOV](#) [PREL](#) [RU](#) [GG](#)  
SUBJECT: GEORGIA: ECONOMY 2003 TO 2008 - A CASE STUDY OF  
PROGRESS

Classified By: Ambassador John F. Tefft for reasons 1.4 (b) and (d).

¶1. (C) Summary and comment. Although often overshadowed by political crisis and conflict over the separatist territories, the Georgian economy has been reformed and developed since the 2003 Rose Revolution. While the August 2008 war with Russia and the ongoing financial crisis continue to present challenges, the Georgian economy remains more robust, more diversified, and less corrupt than the economy inherited by President Saakashvili and his team in ¶2004. In five years, the Georgian government has nearly eliminated the corruption faced by Georgian citizens on a daily basis, ensured stable supplies of electricity and natural gas for businesses and consumers, nearly doubled per capita GDP, increased tax revenues by USD 2283 million annually, and increased FDI from USD 331 million in 2003 to USD 2.015 billion in 2007. The reforms undertaken by the government brought Georgia from 112 in 2005 to 15 in 2008 on the World Bank's Ease of Doing Business report. Of course, areas for additional reform remain, including further development of commercial law and the judiciary, developing export-focused industries and job creation. However what the Saakashvili government has accomplished in the last five years has laid a foundation for a free-market based economy that can survive well after this administration leaves government. End summary and comment.

THE REFORM PLAN ) ADDRESS CORRUPTION, ENERGY ISSUES, FDI

¶2. (C) In its first two years in office, the Saakashvili administration tackled corruption, public sector reform and rule of law. In 2005, the government implemented a new, more business-friendly tax code, undertook a deep liberalization of the economy, and began infrastructure improvements, including much-needed measures in the energy sector. In order to develop and meet this aggressive strategy to reform the economy, attract investment, secure energy availability, and fight corruption, Saakashvili called on western-educated Georgian technocrats for help, many of whom lived abroad. In bringing these experts into the government, Saakashvili created the knowledge base needed to develop and implement the necessary reforms to revitalize the Georgian economy. Many of these experts remain today within the government. In 2006, business reforms began to bear fruit, as foreign direct investment (FDI) flowed into the country and GDP growth took off. This happened despite an embargo by Georgia's biggest trading partner at the time, Russia. Strong economic performance continued in 2007 with significant portfolio inflows. However, many economic reforms were put on the back burner following the November 2007 protests, and subsequent presidential and parliamentary elections in 2008. The new parliament had begun to address additional reforms, when the August 2008 conflict with Russia occurred, with the international economic crisis on its heels.

WHAT A DIFFERENCE A FEW YEARS MAKE

¶3. (C) In 2003, the Georgian economy was rife with corruption that affected all aspects of life, especially business. Transparency International ranked Georgia at 124

with only five countries world-wide rated worse on their corruption perception index. In 2008, Georgia was solidly ranked at 67, due in large part to government efforts to decrease corruption among the tax and patrol police, among others. While Saakashvili's wholesale layoff of the patrol police remains unpopular in some circles even today, hiring a smaller number of police at higher salaries has gone far in combating the every day level of corruption faced by the population. (Note: Many former patrol police are eager participants in protests against the Saakashvili government. End note.) While corruption remains an on-going challenge for the government, the steps to address the issue to date have been nothing short of remarkable. IRI polling numbers (most recently March 2009) have consistently shown that 97 percent of those polled say they do not confront corruption on a daily basis.

#### EVERYTHING WAS DARK, NOW ENERGY ON DEMAND

14. (C) In 2003, electricity and natural gas were a luxury. In many places, including Tbilisi, people did not know how many hours of electricity, if any, they would get during winter months. Natural gas supplies were equally questionable due to lack of payment by the government and overall infrastructure failure. Now, electricity and gas supplies are stable throughout the entire country. Despite challenges to Georgia's energy security following the August conflict, the government was able to meet both electricity and gas demands throughout the winter. In fact, not only was the Ministry of Energy able to meet winter demands for gas, the Minister signed a five year MOU with the Azerbaijani Oil and Gas Company (SOCAR) to meet Georgian social needs at a

TBILISI 00000750 002 OF 002

pre-negotiated, favorable price. Despite de facto Abkhaz Government control of Georgia's largest hydropower facility, electricity continued unabated.

#### GDP NEARLY DOUBLES, TAX COLLECTION INCREASES, FDI SOARS

15. (C) As a result of reforms, the economy continued to grow, even after Russia's 2006 embargo on Georgian products. In 2003, annual GDP per capita stood at USD 2,966. As of February 2009, annual GDP per capita for 2008 was estimated at USD 4,851 -- enough to move Georgia up to a lower middle income country on the Millennium Challenge scale. While it is possible GDP might shrink slightly given the international financial crisis, early estimates for 2008 by international financial institutions put GDP growth at two percent. The Georgians estimate a more conservative one percent.

16. (C) The success of Georgian reforms in the banking sector, tax structures, and overall business practices together with a concerted effort to liberalize and privatize many parts of the economy led to a sharp increase in foreign direct investment (FDI). In 2003, FDI was USD 331 million. In comparison, 2007 FDI stood at 2.015 billion dollars. The economy also began to diversify, as FDI flowed in to nearly all sectors. Fighting corruption in tax collections, while at the same time decreasing the tax burden led to a steep increase in tax revenue collected. In 2004, taxes were a mere 15.8 percent of GDP at 2,267 million GEL (USD 1183 million at 2004 exchange rate). Tax revenues for 2007 (the last full year reported) were 5,791 million GEL (USD 3466 million at 2007 exchange rate) or 25 percent of GDP. 2008 estimates put tax revenue at 28 percent of GDP.

17. (C) An independent indicator of Georgia's economic reform success is the World Bank Ease of Doing Business ranking. In 2004, Georgia was not ranked and in 2005 the country was 115. In 2008 Georgia was ranked 15 in the world in ease of doing business, with special praise for the ease and speed with which a company could start operations.

#### BUSINESS'S CHALLENGES

18. (C) Across the board, business people say that the business climate had improved dramatically from 2003 to 2009.

Crime, mafia involvement, and wholesale corruption were nearly daily issues for most businesses in 2003. One businessman told of a series of events from the late 1990s through 2003 that included the kidnapping of a staff member for 77 days by a competitor with government involvement, murder of a security guard in an armed robbery, as well as RPG and arson attacks on several of his offices. He said that the current government's efforts to combat organized crime and corruption, as well as reform the economy had an immediate and direct positive impact on his business. No longer does he need personal body guards. Other long-term investors in Georgia have praised the government's success in fighting crime as well, noting that this coupled with less government interference have made it significantly easier to do business.

YET TO BE DONE ) JUDICIAL REFORM, MANUFACTURING, JOB CREATION

19. (C) While the Saakashvili government's reform policies have brought significant improvements in the Georgian economy, work still remains, especially in these uncertain economic times. The Georgian judicial system needs to increase its understanding and improve its processing of commercial disputes, and the court system as a whole needs additional transparency for those involved in court cases. In addition, the country's focus for the last five years on attracting investment has been more focused on hard currency attracting investment has been more focused on hard currency earning ventures and less on overall job creation. In order to increase the number of jobs in the country, as well as hard currency inflows now that foreign capital is scarcer, the Georgia government has begun to focus on export potential as well as import substitution.

TEFFT